

thereafter, Old Target is treated as liquidating into Seller in a transaction qualifying under section 332. Seller recognizes no gain or loss on the liquidation. Seller is then treated as purchasing 80 shares of New Target stock from an unrelated person and then distributing the 80 shares of New Target stock to A in exchange for A's 51 shares of Seller stock. Seller recognizes no gain or loss on the distribution of New Target stock pursuant to § 1.336-2(b)(1)(iv). Seller is then treated as purchasing from an unrelated person on the day after the disposition date the 20 shares of Target stock (New Target stock) retained for their fair market value as determined under § 1.336-2(b)(1)(v). The Federal income tax consequences to A are the same as if no section 336(e) election had been made.

*Example 9. Pro-rata distribution of 80 percent of Target stock.* (i) *Facts.* A and B own 60 and 40 shares, respectively, of Seller's only class of stock. Seller owns all 100 shares of Target's only class of stock. Seller distributes 48 shares of Target stock to A and 32 shares of Target stock to B in a transaction that does not qualify under section 355. A section 336(e) election is made.

(ii) *Consequences.* Any stock of a corporation that is owned by Seller would be attributed to A under section 318(a)(2)(C) because, after the distribution, A owns 50 percent or more of the value of the stock of Seller. Therefore, after the distribution, A and Seller are related persons, as defined in § 1.336-1(b)(12), and the distribution of Target stock to A is not a disposition. Because only 32 percent of Target stock was sold, exchanged, or distributed to unrelated persons, there has not been a qualified stock disposition. Accordingly, the section 336(e) election made with respect to the distribution of Target stock has no effect.

(h) *Effective/applicability date.* Paragraph (d)(3)(ii) of this section is applicable to any qualified stock purchase or qualified stock disposition (as defined in § 1.336-1(b)(6)) for which the acquisition date or disposition date (as defined in § 1.336-1(b)(8)), respectively, is on or after May 15, 2013.

(h) *Effective/applicability date.* Paragraph (d)(3)(ii) of this section is applicable to any qualified stock purchase or qualified stock disposition (as defined in § 1.336-1(b)(6)) for which the acquisition date or disposition date (as defined in § 1.336-1(b)(8)), respectively, is on or after May 15, 2013.

[T.D. 9619, 78 FR 28474, May 15, 2013; 78 FR 53027, Aug. 28, 2013]

### § 1.336-3 Aggregate deemed asset disposition price; various aspects of taxation of the deemed asset disposition.

(a) *Scope.* This section provides rules under section 336(e) to determine the aggregate deemed asset disposition price (ADADP) for Target. ADADP is the amount for which old Target is deemed to have sold all of its assets in the deemed asset disposition. ADADP is allocated among Target's assets in the same manner as the aggregate deemed sale price (ADSP) is allocated under § 1.338-6 to determine the amount for which each asset is deemed to have been sold. If a subsequent increase or decrease is required under general principles of tax law with respect to an element of ADADP, the redetermined ADADP is allocated among Target's assets in the same manner as redetermined ADSP is allocated under § 1.338-7.

(b) *Determination of ADADP*—(1) *General rule.* ADADP is the sum of—

- (i) The grossed-up amount realized on the sale, exchange, or distribution of recently disposed stock of Target; and
- (ii) The liabilities of old Target.

(2) *Time and amount of ADADP*—(i) *Original determination.* ADADP is initially determined at the beginning of the day after the disposition date of Target. General principles of tax law apply in determining the timing and amount of the elements of ADADP.

(ii) *Redetermination of ADADP.* ADADP is redetermined at such time and in such amount as an increase or decrease would be required, under general principles of tax law, for the elements of ADADP. For example, ADADP is redetermined because of an increase or decrease in the amount realized on the sale or exchange of recently disposed stock of Target or because liabilities not originally taken into account in determining ADADP are subsequently taken into account. Increases or decreases with respect to the elements of ADADP result in the reallocation of ADADP among Target's assets in the same manner as ADSP under § 1.338-7.

(c) *Grossed-up amount realized on the disposition of recently disposed stock of Target*—(1) *Determination of amount.* The

grossed-up amount realized on the disposition of recently disposed stock of Target is an amount equal to—

(i) The sum of—

(A) With respect to recently disposed of stock of Target that is not distributed in the qualified stock disposition, the amount realized on the sale or exchange of such recently disposed stock of Target, determined as if seller or S corporation shareholders were required to use old Target's accounting methods and characteristics and the installment method were not available and determined without regard to the selling costs taken into account under paragraph (c)(1)(iii) of this section, and

(B) With respect to recently disposed of stock of Target that is distributed in the qualified stock disposition, the fair market value of such recently disposed stock of Target determined on the date of each distribution;

(ii) Divided by the percentage of Target stock (by value, determined on the disposition date) attributable to the recently disposed stock;

(iii) Less the selling costs incurred by seller or S corporation shareholders in connection with the sale or exchange of recently disposed stock that reduce its amount realized on the sale or exchange of the stock (for example, brokerage commissions and any similar costs to sell the stock).

(2) *Example.* The following example illustrates this paragraph (c):

*Example.* Target has two classes of stock outstanding, voting common stock and preferred stock described in section 1504(a)(4). Seller owns all 100 shares of each class of stock. On March 1 of Year 1, Seller sells 10 shares of Target voting common stock to A for \$75. On April 1 of Year 2, Seller distributes 15 shares of Target voting common stock with a fair market value of \$120 to B. On May 1 of Year 2, Seller distributes 10 shares of Target voting common stock with a fair market value of \$110 to C. On July 1 of Year 2, Seller sells 55 shares of Target voting common stock to D for \$550. On July 1 of Year 2, the fair market value of all the Target voting common stock is \$1,000 (\$10 per share) and the fair market value of all the preferred stock is \$600 (\$6 per share). Seller incurs \$20 of selling costs with respect to the sale to A and \$60 of selling costs with respect to the sale to D. The grossed-up amount realized on the sale, exchange, or distribution of recently disposed stock of Target is calculated as follows: The sum of the amount

realized on the sale or exchange of recently disposed stock sold or exchanged (without regard to selling costs) and the fair market value of the recently disposed stock distributed is \$780 (\$120 + \$110 + \$550) (the 10 shares sold to A on March 1 of Year 1 is not recently disposed stock because it was not disposed of during the 12-month disposition period). The percentage of Target stock by value on the disposition date attributable to recently disposed stock equals 50% (\$800 (80 shares of recently disposed stock × \$10, the fair market value of each share of Target common stock on the disposition date)/\$1,600 (\$1,000 (the total value of Target's common stock on the disposition date) + \$600 (the total value of Target's preferred stock on the disposition date))). The grossed-up amount realized equals \$1,500 ((\$780/.50) – \$60 selling costs).

(d) *Liabilities of old Target—(1) In general.* In general, the liabilities of old Target are measured as of the beginning of the day after the disposition date. However, if a Target for which a section 336(e) election is made engages in a transaction outside the ordinary course of business on the disposition date after the event resulting in the qualified stock disposition of Target or a higher-tier corporation, Target and all persons related thereto (either before or after the qualified stock disposition) under section 267(b) or section 707 must treat the transaction for all Federal income tax purposes as occurring at the beginning of the day following the transaction and after the deemed disposition by old Target. In order to be taken into account in ADADP, a liability must be a liability of Target that is properly taken into account in amount realized under general principles of tax law that would apply if old Target had sold its assets to an unrelated person for consideration that included the discharge of its liabilities. See § 1.1001-2(a). Such liabilities may include liabilities for the tax consequences resulting from the deemed asset disposition.

(2) *Time and amount of liabilities.* The time for taking into account liabilities of old Target in determining ADADP and the amount of the liabilities taken into account is determined as if old Target had sold its assets to an unrelated person for consideration that included the discharge of the liabilities by the unrelated person. For example, if no amount of a Target liability is properly taken into account in amount

realized as of the beginning of the day after the disposition date, the liability is not initially taken into account in determining ADADP, but it may be taken into account at some later date.

(e) *Deemed disposition tax consequences.* Gain or loss on each asset in the deemed asset disposition is computed by reference to the ADADP allocated to that asset. ADADP is allocated in the same manner as is ADSP under § 1.338-6. Although deemed disposition tax consequences may increase or decrease ADADP by creating or reducing a tax liability, the amount of the tax liability itself may be a function of the size of the deemed disposition tax consequences. Thus, these determinations may require trial and error computations.

(f) *Other rules apply in determining ADADP.* ADADP may not be applied in such a way as to contravene other applicable rules. For example, a capital loss cannot be applied to reduce ordinary income in calculating the tax liability on the deemed asset disposition for purposes of determining ADADP.

(g) *Examples.* The following examples illustrate this section.

*Example 1.* (i) *Facts.* The facts are the same as in *Example 1* of § 1.336-2(b)(1)(i)(B)(3), that is, Parent owns 60 of the 100 outstanding shares of the common stock of Seller, Seller's only class of stock outstanding. The remaining 40 shares of the common stock of Seller are held by shareholders unrelated to Seller or each other. Seller owns 95 of the 100 outstanding shares of Target common stock, and all 100 shares of Target preferred stock that is described in section 1504(a)(4). The remaining 5 shares of Target common stock are owned by A. On January 1 of Year 1, Seller sells 72 shares of Target common stock to B for \$3,520. On July 1 of Year 1, Seller distributes 12 shares of Target common stock to Parent and 8 shares to its unrelated shareholders in a distribution described in section 301. Seller retains 3 shares of Target common stock and all 100 shares of Target preferred stock immediately after July 1. The value of Target common stock on July 1 is \$60 per share. The value of Target preferred stock on July 1 is \$36 per share. Target has three assets, Asset 1, a Class IV asset, with a basis of \$1,776 and a fair market value of \$2,000, Asset 2, a Class V asset, with a basis of \$2,600 and a fair market value of \$2,750, and Asset 3, a Class V asset, with a basis of \$3,900 and a fair market value of \$3,850. Seller incurred no selling costs on the sale of the 72 shares of

Target common stock to B. Target has no liabilities. A section 336(e) election is made.

(ii) *Determination of ADADP.* The ADADP on the deemed asset disposition of Target is determined as follows. The grossed-up amount realized on the sale, exchange, or distribution of recently disposed stock of Target is \$8,000, the sum of \$3,520, the amount realized on the sale to B of the 72 shares of Target common stock and \$480, the fair market value on the date distributed of the 8 shares of Target common stock distributed to Seller's unrelated shareholders in the qualified stock disposition, divided by .50, the percentage of Target stock by value, determined on the disposition date, attributable to the recently disposed stock (\$4,800 (80 shares of Target common stock disposed of in the qualified stock disposition  $\times$  \$60, the value of a share of Target common stock on the disposition date) divided by \$9,600 ((100, the total number of shares of Target common stock  $\times$  \$60, the value of a share of Target common stock on the disposition date) + (100, the total number of shares of Target preferred stock  $\times$  \$36, the value of a share of Target preferred stock on the disposition date))), minus \$0, Seller's selling costs in connection with the sale of the 72 shares of Target common stock sold to B. The \$8,000 grossed-up amount realized on the sale, exchange, or distribution of recently disposed stock of Target is then added to the liabilities of Old Target, \$0, to arrive at the ADADP, \$8,000.

(iii) *Allocation of ADADP.* The ADADP of \$8,000 is allocated first to Asset 1, the Class IV asset, but not in excess of Asset 1's fair market value, \$2,000. The remaining ADADP of \$6,000 is allocated between Assets 2 and 3, both Class V assets, in proportion to their fair market values, but not in excess of their fair market values. Because the total fair market value of Assets 2 and 3, \$6,600, exceeds the ADADP remaining after allocation of a portion of the ADADP to Asset 1, the \$6,000 remaining ADADP is allocated to Assets 2 and 3 in proportion to their respective fair market values. Accordingly, \$2,500 is allocated to Asset 2 (\$6,000  $\times$  (\$2,750/(\$2,750 + \$3,850))) and \$3,500 is allocated to Asset 3 (\$6,000  $\times$  (\$3,850/(\$2,750 + \$3,850))).

*Example 2.* (i) *Facts.* The facts are the same as in *Example 1* except that Asset 2 is the stock of Target Subsidiary, a corporation of which Target owns 100 of the 110 shares of common stock, the only outstanding class of Target Subsidiary stock. The remaining 10 shares of Target Subsidiary stock are owned by D. The value of Target Subsidiary stock on July 1 is \$27.50 per share. Target Subsidiary has two assets, Asset 4, a Class IV asset, with a basis of \$800 and a fair market value of \$1,000, and Asset 5, a Class IV asset, with a basis of \$2,200 and a fair market value of \$2,025. Target Subsidiary has no liabilities.

## § 1.336-4

## 26 CFR Ch. I (4-1-14 Edition)

A section 336(e) election with respect to Target Subsidiary is also made.

(ii) *Determination of ADADP.* The ADADP on the deemed asset disposition of Target Subsidiary is determined as follows. The grossed-up amount realized on the sale, exchange, or distribution of recently disposed stock of Target Subsidiary is \$2,750, (\$2,500 ADADP allocable to Asset 2, the 100 shares of the stock of Target Subsidiary owned by Target, divided by .909, the percentage of Target Subsidiary stock by value, determined on the disposition date, attributable to the recently disposed stock (\$2,750 (100 shares of the stock of Target Subsidiary deemed disposed in the qualified stock disposition  $\times$  \$27.50, the value of a share of Target Subsidiary stock on the disposition date) divided by \$3,025 (110, the total number of shares of Target Subsidiary stock  $\times$  \$27.50, the value of a share of Target Subsidiary stock on the disposition date)), minus \$0, Seller's selling costs in connection with the deemed sale of the 100 shares of Target Subsidiary stock). The \$2,750 grossed-up amount realized on the sale, exchange, or distribution of recently disposed stock of Target Subsidiary is then added to the liabilities of Old Target Subsidiary, \$0, to arrive at the ADADP of Target Subsidiary, \$2,750.

(iii) *Allocation of ADADP.* Because Assets 4 and 5 are each assets of the same class, and the total fair market value of Assets 4 and 5 exceeds the \$2,750 ADADP of Target Subsidiary, the \$2,750 ADADP is allocated to Assets 4 and 5 in proportion to their respective fair market values. Accordingly, \$909 is allocated to Asset 4 (\$2,750  $\times$  (\$1,000/(\$1,000 + \$2,025))) and \$1,841 is allocated to Asset 5 (\$2,750  $\times$  (\$2,025/(\$1,000 + \$2,025))).

*Example 3.* (i) Seller owns all 100 of the outstanding shares of the common stock of Target, the only class of Target stock outstanding. On January 1 of Year 1, Seller sells 10 shares of Target stock to A for \$6,000 (\$600 per share). On August 1 of Year 1, Seller distributes the remaining 90 shares of Target stock to its unrelated shareholders in a transaction described in section 355(d)(2) or (e)(2). The value of Target stock on August 1 is \$560 per share. Target has two assets, Asset 1, which is stock in trade of Target, a Class IV asset, with a basis of \$15,000 and a value of \$50,000, and Asset 2, which is stock in a publicly traded, unrelated corporation, a Class II asset, with a basis of \$38,000 and a value of \$16,000. Target has no liabilities other than any liabilities for Federal tax on account of the deemed asset disposition. Assume Target's Federal tax rate for any gain or income on the deemed asset disposition is 34 percent. Seller had no selling costs in connection with its sale of the 10 shares of Target stock. A section 336(e) election is made.

(ii) Because at least 80 percent of Target stock was disposed of (within the meaning of § 1.336-1(b)(5)) by Seller during the 12-month

disposition period, a qualified stock disposition occurred. August 1 of Year 1 is the disposition date. Accordingly, pursuant to the section 336(e) election, for Federal income tax purposes, Target is treated as if, on August 1, it sold all of its assets to an unrelated person in exchange for the ADADP.

(iii) Under these facts, although a portion of the qualified stock disposition was the result of a stock distribution, because the grossed-up amount realized on the disposition of recently disposed stock of Target, \$56,400 (((\$6,000 + (\$560  $\times$  90))/1) exceeds Target's total basis in its assets, none of the losses realized on the deemed asset disposition are disallowed under § 1.336-2(b)(2)(i)(B)(2). Because the grossed-up amount realized on the disposition of recently disposed stock of Target exceeds the value of Asset 2, the ADADP allocated to Asset 2 equals the value of Asset 2, \$16,000, and Target realizes a \$22,000 loss on the deemed disposition of Asset 2. None of this loss is disallowed under section 1091. See § 1.336-2(b)(2)(ii)(C). Accordingly, Target recognizes a \$22,000 loss on the deemed disposition of Asset 2.

(iv) The ADADP allocated to Asset 1 is determined as follows (for purposes of this *Example 3*, TotADADP is the total ADADP for the deemed asset disposition, A1ADADP is the tentative amount of the total ADADP allocated to Asset 1, A2ADADP is the amount of the total ADADP allocated to Asset 2, G is the grossed-up amount realized on the disposition of recently disposed stock of Target, L is Target's liabilities other than Target's tax liability for the deemed disposition tax consequences,  $T_R$  is the applicable tax rate, and B1 is the adjusted basis of Asset 1 and B2 is the adjusted basis of Asset 2):

$$\begin{aligned} \text{TotADADP} &= G + L + (T_R \times (\text{TotADADP} - B1 - B2)) \\ \text{A1ADADP} &= \text{TotADADP} - \text{A2ADADP} \\ \text{A2ADADP} &= \$16,000 \\ \text{A1ADADP} &= \text{TotADADP} - \$16,000 \\ G &= (\$6,000 + (\$560 \times 90))/1 \\ G &= \$56,400 \\ \text{TotADADP} &= \$56,400 + 0 + (.34 \times (\text{TotADADP} - \$15,000 - \$38,000)) \\ \text{TotADADP} &= \$56,400 + .34\text{TotADADP} - \$18,020 \\ .66\text{TotADADP} &= \$38,380 \\ \text{TotADADP} &= \$58,152 \\ \text{A1ADADP} &= \$42,152 \end{aligned}$$

(v) Because A1ADADP, \$42,152, does not exceed the value of Asset 1, \$50,000, the entire A1ADADP is allocated to Asset 1. Old Target thus realizes and recognizes a gain of \$27,152 on the deemed disposition of Asset 1 (\$42,152 - \$15,000).

[T.D. 9619, 78 FR 28474, May 15, 2013]

### § 1.336-4 Adjusted grossed-up basis.

(a) *Scope.* Except as provided in paragraphs (b) and (c) of this section or as the context otherwise requires, the